MOODY'S INVESTORS SERVICE

CREDIT OPINION
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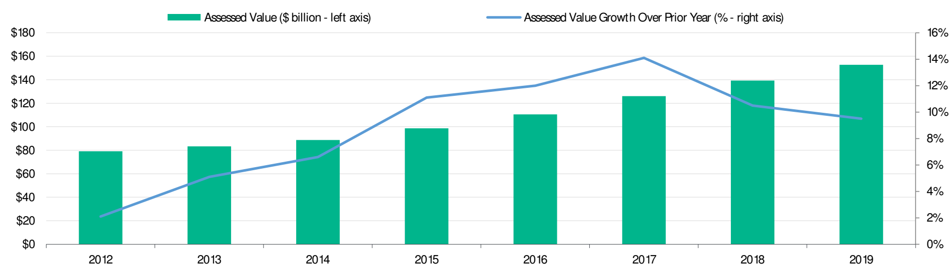
Austin (City of) TX

Update to credit analysis

Summary

Austin's, TX (Aaa stable) credit profile benefits from the vibrant and rapidly growing local economy as well as the added strength to the employment and economic base provided by two large institutions, the University of Texas and the State Capitol. The profile additionally benefits from a history of stable financial performance and reserves, above average income levels, and a manageable debt profile. Challenges of the profile include an elevated pension burden and fixed costs as well as projected growth in underfunding of annual pension requirements, albeit modest, when using Moody's tread water analysis.

Exhibit 1
Rapid taxable value growth continues through fiscal 2019



Source: Travis, Williamson, and Hays Central Appraisal Districts

Credit strengths

» Large, diverse, and growing economy that benefits from significant institutional presence

» Stable financial performance and liquidity driven by policy

» Strong employment and population trends

Credit challenges

» Elevated pension burden

» High fixed cost burden with growing tread water gap

» Growing service demands due to rapid population growth

Rating outlook

The stable outlook reflects Moody's expectation of solid near-term economic growth and further diversification of the local economy and the assumption that the city's experienced

administrative team will continue to produce stable financial performance and metrics. An elevated pension burden, high fixed costs, and a growing tread water gap will continue to weigh on the credit profile, but the city's rapid economic and revenue growth, anticipated surplus operations, and ample revenue raising flexibility are strong positive factors that mitigate this pressure.

Factors that could lead to an upgrade

» Not applicable at the Aaa level

Factors that could lead to a downgrade

» Poor financial performance leading to a significant decline or prolonged weakness in reserve levels

» Economic contraction signaled by decline in taxable values

» Inability to manage pension burden or rising fixed costs; growth in tread water gap and Moody's adjusted net pension liability

» Significant increase in debt profile absent corresponding tax base growth

Key indicators

Exhibit 2

Austin (City of) TX	2013	2014	2015	2016	2017
Economy/Tax Base					
Total Full Value/Net Taxable Value ($000)	$83,294,536	$88,766,098	$98,652,179	$110,526,026	$126,146,583
Population	836,800	864,218	887,061	907,779	946,080
Full Value Per Capita	$99,539	$102,713	$111,212	$121,754	$133,336
Median Family Income (% of US Median)	107.0%	108.8%	112.0%	114.6%	114.6%
Finances					
Operating Revenue ($000)	$880,489	$960,533	$996,310	$1,048,239	$1,132,092
Fund Balance ($000)	$162,913	$200,914	$197,167	$182,072	$195,674
Cash Balance ($000)	$160,573	$198,218	$189,719	$181,545	$194,697
Fund Balance as a % of Revenues	18.5%	20.9%	19.8%	17.4%	17.3%
Cash Balance as a % of Revenues	18.2%	20.6%	19.0%	17.3%	17.2%
Debt/Pensions					
Net Direct Debt ($000)	$1,170,899	$1,262,138	$1,347,017	$1,402,253	$1,419,238
3-Year Average of Moody's ANPL ($000)	$2,166,603	$2,322,187	$2,430,336	$2,424,303	$2,755,767
Net Direct Debt / Full Value (%)	1.4%	1.4%	1.4%	1.3%	1.1%
Net Direct Debt / Operating Revenues (x)	1.3x	1.3x	1.4x	1.3x	1.3x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	2.6%	2.6%	2.5%	2.2%	2.2%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	2.5x	2.4x	2.4x	2.3x	2.4x

Operating Revenues, Fund Balance, and Cash Balance represent the city's General & Debt Service Funds combined
Source: City of Austin, TX; Moody's Investors Service

Profile

The City of Austin is roughly 321 square miles and is located in central Texas (Aaa stable) primarily in Travis County (Aaa stable) with smaller portions spanning into Williamson (Aa1 stable) and Hays counties. The city serves as the State Capital and the most recent population estimate is 958,418.

Detailed credit considerations

Economy and tax base: large and vibrant local economy with strong institutional presence

The city's very large and diverse tax base is not only supported by strong institutional presence, but is expected to continue to see notable growth in the near term future given ongoing development. The city's growth has accelerated in the last five years with the fiscal 2019 full valuation of $152.7 billion reflecting a sizeable 9.5% growth over the previous year. The five-year compound annual growth in the city's tax base was a strong 11.5% from 2014 to 2019, which is very favorable in comparison similarly rated and sized cities throughout the US. The top taxpayers and employers are diverse and the local economy benefits from strong institutional presence as the city is home to the state capital and the University of Texas System (Aaa stable), both of which account for a significant amount of employment base in the area. The city's top ten taxpayers account for a modest 4.2% of the total tax base and include tech giants such as Samsung Electronics Co., Ltd. (Aa3 stable) and Apple Inc. (Aa1 stable).

Officials report the real estate market in the area is strong, citing continued growth in home values and numerous residential (single and multifamily) developments under construction throughout the city. Single family housing sales are up through the first half of 2018 and both occupancy levels exceed 90% for multifamily and office space. The health care sector is also expanding with major providers growing operations. Several expansion and upgrade projects are underway at Austin–Bergstrom International Airport (Austin (City of) Airport Enterprise, A1 stable), which recently had its fifth consecutive year of record annual traffic. Other major ongoing developments in the city include the Mueller development and the Dell Seton Medical Center. In addition, the Pentagon recently selected Austin to be the home of the US Army's Futures Command center, which will employ roughly 500 personnel.

According to Moody's Economy.com, the Austin-Round Rock, TX area is in a late expansionary business cycle status. The report also states that the area will grow steadily over the coming year, maintaining a well above-average pace. IT and housing will lead the way. Longer term, the especially well-educated labor force, the high concentration of technology businesses, the relatively low costs of doing business compared with other hightech centers, and fast population growth will yield above-average performance (Précis U.S. Metro/South/May 2018).

Population growth has also remained strong. The current estimate of 958,418 residents reflect a strong 20%+ growth since the 2010 US census. Historically the wealth profile of the city's residents have remained above state and national levels. The 2016 American Community Survey indicates above average income levels, evidenced by a per capita income and median family income of 119.6% and 114.6% of national levels, respectively. The May 2018 unemployment rate of 2.6% was well below that of the state (3.7%) and the nation (3.6%) for the same period. Management reports that roughly 34,000 jobs have been created over the last 12 months and the city has experienced over 8 years of consecutive job growth.

Financial operations and reserves: adequate reserve levels driven by policies

Stable fiscal performance should continue through fiscal 2018 and 2019 given strong revenue growth and expenditure management, which is reflected in the stable outlook for the credit profile. At fiscal year-end 2017 which ended on September 30, 2017, the city's available general fund balance totaled an adequate $171.1 million (17.1% of general fund revenues), which reflected a $10.8 million operating surplus for the year. Management attributes the surplus to favorable budgetary variances for both revenues and expenditures. The majority of the city's reserve position is held in its Emergency and Budget Stabilization Reserves, which are set by policy at 6% of expenditures each to total 12%. Any reserves above this level are typically assigned for use in the upcoming fiscal year budget, but are not necessarily spent and remain available for the city's use. The city's operating fund balance, which includes the general and debt service funds, was also adequate at $195.7 million or 17.3% of operating fund revenues for the fiscal year.

Fiscal year 2017 general fund revenues were primarily derived from a healthy mix of property taxes (41.7% of total general fund revenues), sales tax collections (21.9%), transfers in from the city utility (16.7%), and licenses and permit fees (6.1%). The general fund's reliance on the transfer from the city's utility has fallen in recent years given the growth in other large revenue streams. The city's fiscal 2019 proposed maintenance and operations (M&O) tax rate is $3.29 per $1,000 of assessed valuation which has steadily come down from $3.86 in 2014. Property tax collections remain a still solid revenue stream given significant tax base growth in recent years. In 2017 sales tax revenue growth remained solid at 2.5% over the prior year, but has slowed in comparison to the five year average annual growth rate of 5.9%.

Year-to-date financial performance for fiscal 2018 remains stable. City officials note that property and sales tax collections are slightly above the city's historically conservative budget. Management budgeted for 3% sales tax growth over the prior year and is currently estimating a 4.3% growth year-to-date. Given conservative budgeting and favorable variances, management reports a $19.9 million addition to the city's budget stabilization reserves. Officials anticipate adding a significant 407 new positions next year as well as salary increases for current employees. The city's ability to grow cash reserves in line with the growing budget in order to maintain healthy reserves above the city's formal policy, will be key in future reviews. Inability to maintain adequate reserve levels could result in downward rating pressure.

LIQUIDITY

Liquidity in the general fund totaled $170.9 million at fiscal year-end 2017 or 17.1% of general fund revenues for the year. Inclusive of the debt service fund, the total operating cash position equaled $194.7 million, or an adequate 17.2% of total operating revenues. Given anticipated positive fiscal 2018 performance, we anticipate a healthy cash position will be maintained in the near term.

Debt and pensions: manageable debt burden; elevated pension burden

Despite additional borrowing plans, the city's debt profile will remain manageable in the near-term given the anticipated assessed value growth and amortization of existing debt. Post-sale, the city will have roughly $1.54 billion in limited tax parity debt outstanding. The city's direct debt burden is manageable at 1.0%, which is calculated using fiscal 2019 net taxable assessed valuation and includes a modest amount of support from the city's essential enterprises. Moody's notes the city calculates roughly $285 million of debt is supported by various revenue streams that are collected by the city above and beyond ad valorem tax collections. The city's overall debt burden is above average at 2.8%, which is heavily impacted by debt from various local school districts, led by Austin Independent School District (Aaa stable), as well as Travis and Williamson counties.

The city plans to issue $1.1 billion of debt in fairly level installments through the next six years. The majority of the future issuances are related to the $720 million authorization that voters approved in November 2016. Post sale, $625.5 million of the bond package remains unissued and will be solely used for mobility upgrades and projects.

City Council plans to approach voters for a sizable $925 million bond authorization in November 2018, which will be split into seven different referendums. If all are passed, the authorization would likely be exhausted within a six year time-frame and would only require a $0.20 per $1,000 of assessed value increase in the debt service levy.

DEBT STRUCTURE

Payout of the city's general obligation limited tax debt is average with 68.2% repaid in 10 years and 92% repaid within 15 years. The city's debt service schedule is descending in nature, which provides capacity for future debt without volatility in the interest and sinking fund tax rate. All debt matures in fiscal 2041.

DEBT-RELATED DERIVATIVES

The city has no variable rate debt associated with its limited tax pledge and is not party to any interest rate swaps or other derivative agreements.

PENSIONS AND OPEB

The city's pension and OPEB obligations are elevated for the Aaa rating category. The city participates in funding three contributory, defined benefit retirement plans: the City of Austin Employees' Retirement and Pension Fund (City Employees), the City of Austin Police Officers' Retirement and Pension Fund (Police Officers), and the Fire Fighters' Relief and Retirement Fund of Austin, Texas (Fire Fighters). An Independent Board of Trustees administers each plan. These plans are city-wide single employer funded plans each with a fiscal year end of December 31. While the city's combined pension burden is above average, the city has taken measures to address the funding levels of the three plans. Since 2005 the city has increased its contribution level from 8% to 18% for city employees. In addition, the city established a new benefit tier for personnel in the city employees plan hired after January 1, 2012 to address the cost sustainability of pension benefits. The city's employee plan is the largest contributor to the pension burden, even after granting self-supporting status for half of the contributions related to essential enterprises.

On a GASB basis, the Fire Fighters plan has the best funding levels out of the three plans with a funded ratio of 91.8% as of fiscal year-end 2017. The City Employees and Police Officer plans have much lower funded ratios at 69.8% and 64.7%, respectively.

Moody's fiscal 2017 adjusted net pension liability (ANPL) for the city's three plans, under our methodology for adjusting reported pension data, is $2.95 billion, or 2.6 times operating revenues. The three-year average ANPL to operating revenues ratio is an elevated 2.43 times. The three-year average ANPL to full value ratio is 1.8%. Moody's ANPL reflects certain adjustments we make to improve the comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported liability information but to improve comparability with other rated entities. The city's aggregated ANPL for fiscal 2018 is projected to unfavorably rise to $3.3 billion, or roughly 2.8 times operating revenues, using recently audited information for the three separate pension plans. A key driver to the projected ANPL growth is the decline in the spot rate of the Citibank Pension Liability Index rate (3.6% at December 31, 2017), which we use as the discount rate to estimate unfunded liabilities.

The city currently provides healthcare benefits to retirees and their dependents meeting certain eligibility requirements in the form of other post employment benefits (OPEB). Funding of these benefits continues to be done on a pay-as-you-go basis. Contributions are approved annually by City Council. OPEB costs in fiscal 2017 were $43.1 million, or a manageable 3.8% of operating revenues. Given that the city pays on an annual pay-go basis, the actuarial accrued liability is a significant $1 billion at fiscal year end 2017, which is roughly the size of the 2019 general fund budget.

Total fixed costs including debt service, pension contributions, and OPEB were an elevated 25.9% of fiscal 2017 operating revenues. This fixed cost burden would increase slightly to 27.8% of revenues if the city were to make its "tread water" payment, which highlights the city's underfunding of pension contributions of 1.95% of operating revenues ($22.1 million) in fiscal 2017. The "tread water" indicator measures the annual government contributions required to prevent reported net pension liabilities from growing, under reported assumptions.

Current projections indicate that the city's tread water gap will increase to roughly $30 million for fiscal 2018, which represents roughly 2.5% of operating revenues. Although this figure is significant, the gap in contributions, which essentially highlights an imbalance of operations, is partially offset by the city's anticipated $20 million general fund surplus during the year. In addition, the city's rapid economic growth, strong revenue growth, and ample revenue raising flexibility help mitigate this growing pressure. However, continued unfavorable growth in the city's fixed cost burden, the tread water gap, or Moody's ANPL could lead to downward rating pressure.

Management and governance: council/manager form of government

The city operates under the council/manager form of government where the mayor (elected at-large) and ten councilmembers (elected from ten single member districts) are elected for staggered four year terms. The city council formulates operating policy for the city while the city manager is the chief administrative officer.

Texas Cities have an Institutional Framework score of Aa, which is high. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. Property taxes, one of the sector's major revenue sources are subject to a cap, which cannot be overridden. However, the cap of $25 per $1,000 of assessed values, with no more than $15 allocated for debt, still allows for significant revenue-raising ability. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally greater than 25% of expenditures. Texas is a Right to Work state, providing significant expenditure-cutting ability. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

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